STATE OF CALIFORNIA
FINANCE LETTER - COVER SHEET
FOR FISCAL YEAR 2004/05
DF-46 (REV 03/03)

Department of Finance
915 L Street
Sacramento, CA 95814
IMS Mail Code: A-15

FL #	PRIORITY NO	ORG CODE	DEPARTMENT
1		1730	**Franchise Tax Board**
PROGRAM	ELEMENT	COMPONENT	
Various	Various		

TITLE OF PROPOSED CHANGE:

Phase III Building - Move In-Occupancy Costs

SUMMARY OF PROPOSED CHANGE:

Provide $12.85 million to facilitate the relocation of staff and operations to the new State office buildings and to fund additional maintenance and operating costs

REQUIRES LEGISLATION	CODE SECTION(S) TO BE AMENDED/ADDED	BUDGET IMPACT-PROVIDE LIST AND MARK IF APPLICABLE
☐ YES ☒ NO		☒ ONE-TIME COST ☒ FULL-YEAR COSTS ☒ FACILITIES/CAPITAL COSTS ☐ FUTURE SAVINGS ☐ REVENUE

PREPARED BY:	DATE	REVIEWED BY:	DATE
PROGRAM APPROVAL:			
DEPARTMENT DIRECTOR:	DATE	AGENCY SECRETARY:	DATE

IF PROPOSAL AFFECTS ANOTHER DEPARTMENT, DOES OTHER DEPARTMENT CONCUR WITH PROPOSAL? yes

☒ YES ☐ NO

ATTACH COMMENTS OF AFFECTED DEPARTMENT SIGNED AND DATED BY THE DEPARTMENT DIRECTOR OR DESIGNEE.

FOR INFORMATION TECHNOLOGY REQUESTS, SPECIFY THE DATE SPECIAL PROJECT REPORT (SPR) OR FEASIBILITY STUDY REPORT (FSR) WAS APPROVED BY THE DEPARTMENT OF FINANCE.

DATE PROJECT # FSR ☐ OR SPR ☐

DOF ANALYST USE
(ADDITIONAL REVIEW)

CAPITAL OUTLAY ☐ TIRU ☐ FSCU ☐ OSAE ☐ CALSTARS ☐

STATE OF CALIFORNIA
FINANCE LETTER - FISCAL DETAIL
FOR FISCAL YEAR 2004/05
DF-46 (REV 03/03)

Department of Finance
915 L Street
Sacramento, CA 95814
IMS Mail Code: A-15

FL # 1	DATE 2/6/2004	Title of Proposed Change: Phase III Building - Move In-Occupancy Costs
PROGRAM	ELEMENT	COMPONENT
Various	Various	

	Personnel Years CY	Personnel Years BY	Current Year	Budget Year
Total Salaries & Wages a/	.0	.0	$ 0	$ 0
Salary Savings	.0	.0	$ 0	$ 0
Net Total Salaries and Wages	.0	.0	$ 0	$ 0
Staff Benefits b/			$ 0	$ 0
Total Personal Services			$ 0	$ 0

Operating Expenses and Equipment	Current Year	Budget Year
General Expenses /1	$ 0	$ 5,673,000
Printing	0	0
Communications /2	0	-22,000
Postage	0	0
Travel-In-State	0	0
Travel Out-of-State	0	0
Training	0	0
Facilities Operations /3	0	414,000
Utilities /4	0	1,150,000
Cons & Prof Svs - Interdept'l /5	0	4,925,000
Cons & Prof Svs - External	0	0
Consolidated Data Center	0	0
California Health and Human Services Agency Data Center	( )	( )
Stephen P. Teale Data Center	( )	( )
Data Processing	0	0
Equipment /6	0	460,000
Other Items of Exp /7	0	255,000
Total Operating Expense & Equipment	$ 0	$ 12,855,000

a/ Itemized detail on Page II-3 by classification as in Salaries and Wages Supplement.
b/ Detail provided on following pages.
/1 Costs for disassembling, cleaning, reassembling and for new Haworth component parts to complete workstations.
/2 Reduction of $22,000 from cancellation of telecom/data circuits and trunk lines.
/3 Reduction of $492,000 in rents. Also includes increased costs of $906,000 for supplies, maintenance and service contracts.
/4 Increased utilities costs to service the new building and for diesel fuel for three new on-site generators.
/5 Reimburse DGS for maintenance and operations costs including $4.85 million and $70,000 overtime for BPMB staff
/6 Audiovisual equipment for training rooms $45,000; data connections, wire management $382,000; power distribution

costs and $70,000 in estimated BPMB staff overtime.
conduit and equipment $33,000.
/7 Bicycle lockers $55,000; first-aid rooms equipment & evacuation chairs $105,000; warehouse forklift $28,000; messenger truck and carts $67,000.

Current Year | Budget Year

TOTAL OPERATING EXPENSES AND EQUIPMENT	$ 0	$ 12,855,000
SPECIAL ITEMS OF EXPENSE d/		
	$ 0	$ 0
PROGRAM ADMINISTRATION	$ 0	$ 0
Distributed Admin	$ 0	$ 0
TOTAL STATE OPERATIONS EXPENDITURES	$ 0	$ 12,855,000

Source of Funds	**Appropriation No.** Org	Ref	Fund		
General Fund - Tax	1730	001	0001	$ 0	$ 12,019,480
Motor Vehicle Account	1730	001	0044	0	52,844
Motor Vehicle License Fee Account	1730	001	0064	0	99,986
Court Collections	1730	001	0242	0	168,945
				0	0
				0	0
Reimbursements - Child Sup Collect.	1730	505	0995	0	302,092
Reimbursements	1730	501	0995	0	211,653
Totals				$ 0	$ 12,855,000

LOCAL ASSISTANCE				$(0)	$(0)
Source of Funds	**Appropriation No.** Org	Ref	Fund		
General Fund - Tax	1730	001	0001	$ 0	$ 0
Motor Vehicle Account				0	0
Motor Vehicle License Fee Account				0	0
Court Collections				0	0
Reimbursements - Child Sup Collect.				0	0
Reimbursements				0	0
Totals				$ 0	$ 0

d/ Special Items of expense must be titled. Please refer to the Uniform Codes Manual for a list of the standardized Special Items of expense objects which may be used.

DETAIL OF STAFF BENEFITS AND PERSONAL SERVICES

Positions	**Positions** CY	BY	**Salary Range**	**Amount** CY	BY

Schedule of Staff Benefits Costs
FOR FISCAL YEAR 2004/05

Staff Benefits	2003/04	2004/05
OASDI /1	$ 0	$ 0
Dental /2	0	0
Health /3	0	0
Retirement /4	0	0
Vision /5	0	0
Medicare /6	0	0
Worker's Comp /7	0	0

Industrial Disability /8	0	0
Non Industrial Disability /9	0	0
Unemployment Insurance /10	0	0
Total Staff Benefits	$ 0	$ 0

1/ For permanent and overtime, 6.2% of net salary.
2/ For permanent, $500 per net personnel year.
3/ For permanent, $4,300 per net personnel year.
4/ For permanent, 7.413% of net salary.
5/ For permanent, $100 per net personnel year.
6/ 1.45% of net salary for permanent.
7/ 0.95% of net salary for permanent.
8/ 0.075% of net salary for permanent.
9/ 0.09% of net salary for permanent.
10/ 7.262% of net salary for temporary help.

Department **Franchise Tax Board** FL 1

Phase III Building - Move In-Occupancy Costs

FISCAL YEAR 2004/05
SUPPLEMENTAL INFORMATION
($ in Thousands)

Identify all proposed items which fit into the categories listed below.

		Current Year	Budget Year	Budget Year + One
Proposed Equipment				
	Audio-visual equipment	$ 0	$ 45	$ 0
	Bicycle lockers		55	
	Warehouse forklift		28	
	Messenger truck and carts		55	
	Total	$ 0	$ 183	$ 0
Proposed Contracts				
	Move Contracts	$ 0	$ 575	$ 205
	Total	$ 0	$ 575	$ 205
One-Time Costs				
	Modular furniture components-Haworth	$ 0	$ 3,082	$ 939
	Audio Visual equipment	0	45	
	Bicycle lockers		55	
	Warehouse forklift		28	
	Messenger truck and carts		67	
	Data connections, wiring and conduits		425	
	Total	$ 0	$ 3,702	$ 939
Future Savings				
	Cancellation of Leased Space	$ 0	-$ 492	-$ 6,090
	Cancellation of Telecom/Data Contracts		-22	-280
	Total	$ 0	-$ 514	-$ 6,370
Full-Year Cost Adjustments				
	BPMB staff costs	$ 0	$ 4,855	$ 11,457
	Total	$ 0	$ 4,855	$ 11,457
Facilities/Capital Costs				
		$ 0		
	Total	$ 0	$ 0	$ 0

FRANCHISE TAX BOARD
Fiscal Year 2004/05

Finance Letter	**FL No. 1**
Phase III – Move-In-Occupancy Costs	**Date: February 6, 2004**

A. Nature of Request

The Franchise Tax Board (FTB) is requesting funding of $12.85 million to facilitate the relocation of staff and operations to the new State Office and Warehouse Facilities at Butterfield Way Project (State Office Project also known as Phase III). The following FY 2004/05 expenditures and projected savings are associated with the move and occupancy of Phase III based on the current construction schedule:

- $6,976,000 - Maintenance and Operating Costs.
- -$ 492,000 - Savings resulting from cancellation of 168,587 square feet of leased office space
- -$ 22,000 - Savings resulting from cancellation of Telecom/Data Circuits and Trunk Lines in FY 2004/05
- $5,672,000 - Modular Systems Furniture Disassembly/Reassembly/Cleaning Contract.
- $ 715,000 - Facilities Related Equipment.

B. Background/History

The Phase III project is based on Senate Bill 1589 (Chapter 328/1998) authorizing the Department of General Services to use lease revenue funds for the acquisition of land, design, and construction of the State Office Project. The consolidation strategies expressed in FTB's 1995 Master Plan Report and confirmed in the subsequent 1998 Update supported the authorizing legislation. The consolidation of FTB staff currently housed in leased space at the expanded Butterfield campus is consistent with the provisions of Executive Order D-46-01 directing agencies to utilize state-owned facilities when accommodating future space requirements. FTB anticipates that the consolidation will promote efficiencies that will result in certain monetary savings. The precise identification of savings is difficult to measure at present. FTB will evaluate and submit more conclusive findings after occupancy of Phase III.

Current Issues:

FTB received an augmentation in the amount of $813,000 for FY 2003/04 to move furniture and staff into the new office building ($693,000) and to provide for BPMB staff costs ($120,000). This amount will remain in FTB's budget for FY 2004/05 to provide for the full-year costs for BPMB staff of $313,000 and the balance towards move costs estimated to be $575,000 in FY 2004/05.

Debt service for the bond sale related to completion of the Central Plant, site work and warehouse is due in FY 2004/05. It has not been determined if this debt service payment will be paid by FTB, and the amount has not been included in FTB's budget or in this request.

Detail of FY 2004/05 Augmentation Request:

The State Office Project includes construction of a central plant, warehouse, Town Center and office buildings. Typically, maintenance and operation of those facilities is the responsibility of the Department of General Services, Building and Property Management Branch (BPMB) with FTB paying for the essential building operating costs, such as BPMB salaries, increased utilities, expendable supplies, and preventative maintenance programs. Services and equipment required for FTB's occupancy impacting FTB's baseline support budget are not funded by the State Office Project, and are the subject of this funding request:

1. **Maintenance and Operating Costs - $6.97 Million**
   The current 851,000 gross square foot Butterfield office and warehouse facility will expand to approximately 1,851,000 gross square feet upon completion of the State Office Project. FTB received funding in FY 2003/04 for increased maintenance and operating costs related to the completion of the new central plant and the newly constructed parking lots. As building systems continue to be commissioned and facilities are occupied, additional staffing will be required to provide the support and maintenance appropriate for the expanded campus.

   In this regard, DGS has prepared a phased hiring plan for FY 2004/05 based on Department of Finance (DOF) recognized staffing standards for BPMB provided property management, buildings and grounds maintenance, and associated trades. The plan is consistent with the state policy on staffing new state office buildings and is critical to the hiring and training of staff in order to maintain service levels.

   In the past FTB has paid for the essential building operating costs, such as BPMB salaries, increased utilities, expendable supplies, and preventative maintenance programs. Consistent with past practice, FTB requests an augmentation in FY 2004/05 of $4.85 million to fund the additional staff to be hired by BPMB in FY 2004/05; $906,000 for increased supplies, essential building maintenance commodities, and increased service contracts; and $70,000 for estimated BPMB staff overtime. The estimated salaries are based on the DGS Price Book for FY 2003/04 with a 5% adjustment for an inflationary salary increase.

   Although the Project will exceed the Title 24 standards for energy efficiency by over 20 percent, the expansion of the Butterfield facility by approximately 1,000,000 gross square feet will result in increased utility costs. The increased utility costs and purchase of diesel fuel for the three new on-site generators is estimated at $1.15 million for FY 2004/05.

2. **Savings resulting from Cancellation of Leased Office Space - $492,000**
   The FTB will be the major tenant of the new State Office Project. This relocation has implications in that all segments of the FTB organization will be affected by the multi-phased occupancy of the new facilities. Following construction of the State Office

Project, FTB will relocate staff and operations from approximately 463,000 square feet of leased facilities in the Sacramento Highway 50 corridor to the new office buildings. The consolidation of the FTB organization at the expanded Butterfield campus will streamline FTB's local operations. In addition to projected rental and DGS lease management savings of $492,000 in FY 2004/05 associated with the cancellation of 168,587 square feet of leased space, a savings of $6.1 million will be realized in FY 2005/06 upon cancellation of 294,176 square feet of leased space.

3. **Savings resulting from Cancellation of Telecom/Data Contracts - $22,000**
   In addition to the savings resulting from the cancellation of leased space, there will also be savings from cancellation of the telecom/data contracts associated with those leased facilities. It is estimated that the cancellation of the telecom/data circuits and trunk lines will result in savings of $22,000 in FY 2004/05 and $280,000 in FY 2005/06.

4. **Modular System Furniture - $5.67 Million; Multi-Year Contract for Modular System Furniture Disassembly/Reassembly/Cleaning Contract.**
   Consolidation of FTB operations at the expanded Butterfield campus by relocation of staff occupying approximately 463,000 square feet of leased space will be accomplished in multiple stages pursuant to the State Office Project construction schedule. The modular system furniture (modular) associated with the initial staff relocated in FY 2004/05 will be new PIA product purchased with State Office Project funds.

   FTB is planning to re-use its existing modular for the subsequent staff relocations. This is consistent with the Department of Finance recommendations and sustainable building practices. It is important to note that the existing modular has been designed to respond to the floor plates and column configurations of FTB's Central Office and leased facilities. The new office building floor plates and column distribution differs substantially from those facilities, and the modular design responds to those structural elements to achieve efficient occupancy.

   Integral to the re-use is the procurement of a multi-year contract for the professional services of a vendor to disassemble, reassemble and clean the modular in a timely manner. FTB does not have staff that is trained or authorized to accomplish these tasks. Since the modular vacated may not meet the requirements of the next moves, the purchase of new components to augment existing inventory is necessary to complete the installations. The total cost of disassembling, reassembling, cleaning and new components required in the FY 2004/05 move stages is estimated to be $5.67 million. This is based on the assumption that an additional $ 772,000 cost of disassembling and moving workstations vacated in those initial moves are funded by State Office Project funds.

   In comparison with the purchase of new Haworth modular, re-use costs requested represent a savings of $2.1 million in FY 2004/05. One additional FTB move to the new State Office Project office buildings will occur in FY 2005/06 that is not included in this request. Denial of this request will prohibit effective re-use of FTB's existing modular inventory, require purchase of new modular and conflict with sustainable building design practices. Insufficient components will delay modular installations and increase FTB support costs. FTB would incur an undetermined rental cost for

State Office Project space available for occupancy and will not realize rental savings estimated at $492,000 in FY 2004/05, and potentially $6.1 million in FY 2005/06. Failure to cancel leases will result in foregoing telecom/data contract savings of $22,000 in FY 2004/05 and $280,000 in FY 2005/06.

5. **Facilities Related Equipment - $715,000**
The State Office Project provides the facilities to relocate FTB staff from Central Office and leased facilities. Organizations now fragmented among multiple sites will be co-located improving functional adjacencies. Centralization of FTB's network infrastructure will modernize management and monitoring of its critical systems minimizing response to power or network disruptions. These improvements will provide long-term benefits as FTB administers the Revenue and Taxation Code, and collects revenue. As with any relocation of staff, facility related purchases are required to utilize the new warehouse and office buildings. FTB's budget has been affected by the current budget reductions and funds are not available to purchase the following items not included in the State Office Project budget:

   a. **Data Center Purchases - $415,000**
   In order to operate the Data Center built by the State Office Project FTB must purchase services and materials necessary for data connections and wire management at an estimated cost of $382,000. Furthermore, conduit and equipment related to the power distribution units is required at an estimated cost of $33,000.

   b. **Health and Safety Purchases - $105,000**
   The health and safety of FTB staff is contingent on appropriately equipped first aid rooms, and evacuation chairs for timely evacuation of disabled staff at an estimated cost of $105,000. There are 15 first aid rooms in the office buildings that must be equipped with cots, wheelchairs and first aid supplies as well as 30 stairwell locations that must be equipped with evacuation chairs for the safety of disabled staff in case of an emergency evacuation.

   c. **Warehouse and Delivery Equipment - $95,000**
   FTB storage needs were met in the new warehouse through higher storage systems and a smaller floor plate. The purchase of a forklift capable of reaching the high storage at a cost of $28,000 is needed to utilize the warehouse storage capacity and meet department storage needs. The existing forklift will remain at the Central Office dock to assist with the mail operation and data warehouse activities.

   FTB will relocate its shipping and receiving operations including IT products at the new warehouse. Currently, 50% of the IT shipments are bulk pallet deliveries and 50% are small deliveries that may be hand carried. Bulk pallet deliveries will be made by diesel truck. A transportation vehicle at an estimated cost of $12,000 will provide a clean environmentally sensitive method of transportation for staff who need to transport materials and goods from the warehouse to the office buildings. The transportation vehicle will reduce fuel and repair costs associated with the diesel truck.

   While consolidation at the Butterfield campus will reduce external deliveries, it will increase internal trips between the warehouses and the office buildings. FTB's existing diesel trucks have met their useful life expectancy and exceeded 200,000 miles of travel. There is a great likelihood that one or more of these vehicles will require extensive repairs or replacement. A propane truck at an estimated cost of $42,000 would reduce annual diesel truck mileage, fuel and maintenance costs. It would also address air quality issues expressed by the neighborhood relative to the use of diesel trucks.

Current messenger services are conducted with diesel trucks and vans that transport materials and mail between Central Office and the leased facilities. In lieu of diesel trucks and vans, messenger carts will be used to provide delivery service to customers relocated from leased space to the multi-floor office buildings. Existing messenger carts will continue to deliver materials and mail within the two Central Office buildings, and two additional messenger carts at a total cost of $13,000 will be required to provide the delivery service to the multi-floor office buildings. The use of messenger carts will further reduce fuel, repair and maintenance costs for the trucks and vans.

d. Bicycle Locker Purchase - $55,000

The FTB 1995 and 1998 Master Plan Update Reports recognized that the expansion of the Butterfield facility provided an opportunity to promote the use of alternate modes of transportation. These reports acknowledged that every effort must be made to achieve a 33% - 40% alternate mode use in order to reduce the land required for parking. The mode split goals formed the basis for determining the number of parking spaces needed at the State Office Project, and established requirements for the on-site and off-site transportation infrastructure. Those goals reflected an increase in the walk/bicycle mode from 1.5% to 3%.

The State Office Project is in direct proximity to the RT Butterfield Light Rail Station, with a new bicycle path to that station and designated areas on site for bicycle lockers. There are shower and locker rooms in the Town Center and on the first floors of the office buildings. These attributes enhance FTB's efforts to increase the use of bicycles for transportation. Accessibility to bicycle lockers near entrances to the site will further promote bicycling as an alternative to driving alone. Upon direction from the Department of Finance, State Office Project bid savings will fund the purchase of bicycle lockers adjacent to the first office building occupied by FTB. This request for $55,000 will fund the remaining bicycle lockers required at the Butterfield campus.

If the alternative transportation goals are not reached, there will be an increase in traffic congestion and air pollution, a greater demand on the roadway infrastructure, and a likelihood that FTB staff will park in adjacent residential and commercial areas due to insufficient on-site parking. This will be detrimental to community relations, and may affect the ability of the State of California to locate other projects within Sacramento County.

e. Audiovisual Equipment - $45,000

FTB will be the primary occupant of the office buildings constructed by the State Office Project. Training and conference rooms were strategically located between the new office buildings to address the training needs of FTB's collection, audit and filing services programs. Bid savings were identified to fund the purchase and installation of projectors in the first office building occupied by FTB. This request for $45,000 is for the purchase and installation of projectors in the remaining training and conference rooms in the new office buildings. The training and updating of FTB staff on new systems and procedures is critical to administering the tax laws of the State of California. FTB is responsible for 61% of the state revenue. Delivery of efficient business results, and implementation of electronic government services is dependent on a skilled workforce. Failure to provide the training equipment may affect the ability of FTB staff to optimally perform their jobs.

C. State Level Consideration:

In accordance with Executive Order D-16-00 the goal of the State Office Project is to construct, renovate, operate and maintain facilities that are models of energy, water and materials efficiency while providing a healthy, productive indoor and outdoor environment for staff. This Project will be a long-term benefit to the State of California. FTB will be the primary occupant, and is responsible for 61% of the state revenues.

This is a request to adequately maintain and efficiently utilize the programmed facilities. This investment will garner the long-term benefits of energy cost savings, delivery of efficient state services, protection of investment of state funds, and reduction of leasing and operating costs. To continue leasing space to meet FTB program requirements conflicts with the provisions of Executive Order D-46-01 directing agencies to utilize state-owned facilities when accommodating future space requirements.

D. Facility/Capital Outlay Considerations:

Failure to appropriately staff the operating and maintenance functions at the expanded campus will result in possible voided warranties, premature equipment failure and inability for FTB to achieve energy efficiency goals, all of which deteriorates the infrastructure established by the State Office Project investment.

E. Justification:

The consolidation of FTB staff with the State Office Project supports FTB's 1995 and 1998 Master Plan Update, and will allow for improved communications and efficiencies for FTB pursuant to FTB Strategic Goal #3 to build a strong organization. Strategic Goal #4 to deliver efficient business results is dependent on suitable facilities for staff. This funding request further supports this same goal as FTB resources are allocated based on the overall long-term benefits to our customers, our organization, and California as a whole.

Appropriately operating and maintaining the facility will reduce long-term costs associated with deferred maintenance and insure the energy efficiencies inherent in the State Office Project design.

F. Analysis of All Feasible Alternatives

<u>Alternative #1</u> – Approve $12.85 million for modular re-use costs; increases in operating and maintenance costs; and the purchase of new facilities related equipment.

This alternative recommends the requisite funding for re-use of existing modular, purchase of facility related equipment, and appropriate operation and maintenance of the facilities at the expanded Butterfield site. This will allow the department to cover the one-time equipment costs and increased operating and maintenance costs associated with its occupancy of the State Office Project, and provide the current level of service.

<u>Alternative #2</u> - Reduce Operating Costs through contract janitorial services, and approve $12.25 million.

This alternative presents the option of contracting the janitorial services for a possible annual savings of $600,000 to $1 million in building maintenance depending on the labor rate. Contract janitorial services have been utilized in the past to maintain FTB's Central Office facilities.

<u>Alternative #3</u> - Do not approve funding request.

If this funding request is not approved, FTB will be unable to consolidate at the Butterfield site in an efficient and timely manner. Delays in occupying the facilities may adversely affect FTB's operations and level of service, and cause FTB to incur double rental costs consisting of an undetermined rental cost for State Office Project space available for occupancy together with lease costs estimated at $492,000 in FY 2004/05, and potentially $6.1 million in FY 2005/06. Furthermore, energy efficiencies and the resultant savings will not be realized if the new facility is not adequately maintained.

G. <u>Timetable</u>

Increase support funding effective July 1, 2004.

H. <u>Recommendation</u>

Alternative #1 is recommended. This enables the department to relocate in a timely manner and operate efficiently without impacting its ability to provide the current level of service. At its meeting on September 17, 2003, the Franchise Tax Board itself approved the funding request for Phase III move-in occupancy costs. This funding request was submitted to the Department of Finance in the fall of 2003 as a BCP. At that time, the Department of Finance requested that the FTB resubmit the request in the spring as a Finance Letter.

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Department of Finance
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IMS Mail Code: A-15

FL #	PRIORITY NO	ORG CODE	DEPARTMENT
2		**1730**	**Franchise Tax Board**

PROGRAM	ELEMENT	COMPONENT
45 CCSAS	00 CCSAS	

TITLE OF PROPOSED CHANGE:

Child Support Automation System (CCSAS)

SUMMARY OF PROPOSED CHANGE:

This Finance Letter requests a an augmentation of $17.7 million to continue the development phase of CCSAS for FY 2004/05. The goal of the CCSAS project is to improve services for children and to meet federal mandates.

The budget augmentation is to realign the Alliance payments; add an additional nine positions (8.7 PY's); revise the Wide Area Network (WAN) estimates; and for CMAS/MSA Department of General Services (DGS) Administrative fees necessary to continue development and implementation of the CCSAS CSE Project.

REQUIRES LEGISLATION	CODE SECTION(S) TO BE AMENDED/ADDED	BUDGET IMPACT-PROVIDE LIST AND MARK IF APPLICABLE
☐ YES ☒ NO		☒ ONE-TIME COST ☐ FULL-YEAR COSTS ☐ FACILITIES/CAPITAL COSTS ☐ FUTURE SAVINGS ☐ REVENUE

PREPARED BY:	DATE	REVIEWED BY:	DATE
PROGRAM APPROVAL:			
DEPARTMENT DIRECTOR:	DATE	AGENCY SECRETARY:	DATE

IF PROPOSAL AFFECTS ANOTHER DEPARTMENT, DOES OTHER DEPARTMENT CONCUR WITH PROPOSAL? YES

☒ YES ☐ NO

ATTACH COMMENTS OF AFFECTED DEPARTMENT SIGNED AND DATED BY THE DEPARTMENT DIRECTOR OR DESIGNEE.

FOR INFORMATION TECHNOLOGY REQUESTS, SPECIFY THE DATE SPECIAL PROJECT REPORT (SPR) OR FEASIBILITY STUDY REPORT (FSR) WAS APPROVED BY THE DEPARTMENT OF FINANCE.

DATE 12-Jun-03 PROJECT # 1730 - 150 FSR ☒ OR SPR ☐

DOF ANALYST USE
(ADDITIONAL REVIEW)

CAPITAL OUTLAY ☐ TIRU ☐ FSCU ☐ OSAE ☐ CALSTARS ☐

STATE OF CALIFORNIA
FINANCE LETTER - FISCAL DETAIL
FOR FISCAL YEAR 2004/05
DF-46 (REV 03/03)

Department of Finance
915 L Street
Sacramento, CA 95814
IMS Mail Code: A-15

FL # 2	**DATE** 6-Feb-04	**Title of Proposed Change:** Child Support Automation System (CCSAS)
PROGRAM CCSAS	**ELEMENT** CCSAS	**COMPONENT**

	Personnel Years CY	Personnel Years BY	Current Year	Budget Year
Total Salaries & Wages a/	.0	9.0	$ 0	$ 587,000
Salary Savings	.0	-.3	$ 0	-$ 20,000
Net Total Salaries and Wages	.0	8.7	$ 0	$ 567,000
Staff Benefits b/			$ 0	$ 133,000
Total Personal Services			$ 0	$ 700,000

Operating Expenses and Equipment	Current Year	Budget Year
General Expenses /1	$ 0	$ 319,000
Printing /2	0	1,000
Communications /3	0	9,000
Postage	0	0
Travel-In-State	0	0
Travel Out-of-State	0	0
Training	0	0
Facilities Operations	0	0
Utilities	0	0
Cons & Prof Svs - Interdept'l	0	0
Cons & Prof Svs - External /4	0	16,219,000
Consolidated Data Center /5	0	478,000
California Health and Human Services Agency Data Center	( )	( )
Stephen P. Teale Data Center	( )	( )
Data Processing /6	0	16,000
Equipment	0	0
Other Items of Exp (Specify Below)	0	0
Total Operating Expense & Equipment	$ 0	$ 17,042,000

a/ Itemized detail on Page II-3 by classification as in Salaries and Wages Supplement.
b/ Detail provided on following pages.
/1 General expense for 9 positions plus $281,000 DGS fees
/2 Departmental $102 per position.
/3 Departmental $992 per position for nine new positions.
/4 FY 2004/05 includes increase in funding need for the BP Contract. This need may be reduced once the carryover amount from FY 2003/04 to FY 2004/05 can be estimated.
/5 Increase in contract with HHSDC for data center services.
/6 Software for PCs@$1592 per PC.

		Current Year	Budget Year
PROGRAM ADMINISTRATION		$ 0	$ 0
Distributed Admin		$ 0	$ 0
TOTAL STATE OPERATIONS EXPENDITURES		$ 0	$ 17,742,000

Source of Funds	**Appropriation No.** Org - Ref - Fund		
General Fund	1730 - 001 - 0001	$ 0	$ 6,082,000
		0	
		0	
		0	
		0	
		0	
		0	
Reimbursements (DCSS - 66%)	1730 - 506 - 0995	0	11,660,000
Totals		$ 0	$ 17,742,000

LOCAL ASSISTANCE		$(0)	$(0)
Source of Funds	**Appropriation No.** Org - Ref - Fund		
General Fund	1730 - 001 - 0001	$ 0	$ 0
		0	0
		0	0
		0	0
		0	0
Reimbursements (DCSS - 66%)		0	0
Totals		$ 0	$ 0

d/ Special Items of expense must be titled. Please refer to the Uniform Codes Manual for a list of the standardized Special Items of expense objects which may be used.

DETAIL OF STAFF BENEFITS
AND PERSONAL SERVICES

Positions		Positions CY	Positions BY	Salary Range		Amount CY	Amount BY
Child Support Automation		2003/04	2004/05				
Staff Prog Analyst Spec	PERM	0.0	2.0	$ 4,507	$ 5,480	$ 0	$ 132,000
Staff Info Sys Analyst Spec	PERM	0.0	4.0	$ 4,507	$ 5,480	$ 0	$ 263,000
Sys Software Spec I Tech	PERM	0.0	1.0	$ 4,506	$ 5,479	$ 0	$ 66,000
Assoc Info Systems Analyst	PERM	0.0	1.0	$ 4,110	$ 4,997	$ 0	$ 60,000
Total Child Support Automation		.0	8.0			$ 0	$ 521,000
Adjust for Part Year Positions		.0	.0				
Net Positions/ PYs before salary savings		.0	8.0				
Operations Branch & Enterprise Technology							
Sys Software Spec I Tech	PERM	0.0	1.0	$ 4,506	$ 5,479	$ 0	$ 66,000
Total Operations Branch & Enterprise Technology		.0	1.0			$ 0	$ 66,000
Adjust for Part Year Positions		.0	.0				
Net Positions/ PYs before salary savings		.0	1.0				
Total Salaries and Wages	Positions	.0	9.0			$ 0	$ 587,000
	Part Yr Adj	.0	.0				
	P.Y.s	.0	9.0				

Schedule of Staff Benefits Costs
FOR FISCAL YEAR 2004/05

Staff Benefits	2003/04	2004/05
OASDI /1	$ 0	$ 35,000
Dental /2	0	4,000
Health /3	0	38,000
Retirement /4	0	42,000
Vision /5	0	1,000
Medicare /6	0	8,000
Worker's Comp /7	0	5,000
Industrial Disability /8	0	0
Non Industrial Disability /9	0	0
Unemployment Insurance /10	0	0
Total Staff Benefits	$ 0	$ 133,000

1/ For permanent and overtime, 6.2% of net salary.
2/ For permanent, $478 per net personnel year.
3/ For permanent, $4,348 per net personnel year.
4/ For permanent, 7.413% of net salary.
5/ For permanent, $100 per net personnel year.
6/ 1.45% of net salary for permanent.
7/ 0.95% of net salary for permanent.
8/ 0.075% of net salary for permanent.
9/ 0.09% of net salary for permanent.
10/ 7.262% of net salary for temporary help.

Department **Franchise Tax Board** FL 2

Child Support Automation System (CCSAS)

FISCAL YEAR 2004/05
SUPPLEMENTAL INFORMATION
($ in Thousands)

Identify all proposed items which fit into the categories listed below.

		Current Year	Budget Year
Proposed Equipment			
		$ 0	$ 0
	Total	$ 0	$ 0
Proposed Contracts			
C&P Internal -	HHSDC data center services	$ 0	$ 478,000
C&P External -	Business Partner		16,219,000
	Total	$ 0	$ 16,697,000
One-Time Costs			
		$ 0	See Footnote *1
	Total	$ 0	$ 0
Future Savings			
		$ 0	$ 0
	Total	$ 0	$ 0
Full-Year Cost Adjustments			
		$ 0	$ 0
	Total	$ 0	$ 0
Facilities/Capital Costs			
		$ 0	$ 0
	Total	$ 0	$ 0

*1 This is a multi-year project. As FTB is doing in this BCP and prior multi-year project BCPs, the one-times for FY 2004/05 will be netted out against the FY 2005/06 BCP request.

FRANCHISE TAX BOARD
Fiscal Year 2004/2005

Budget Change Proposal	**Finance Letter #2**
California Child Support Automation System	**Date: February 6, 2004**

A. Nature of Request

In July 2003, with both federal and State approvals in place, the California Child Support Automation System (CCSAS) project moved forward into the implementation phase for development of the single statewide system to automate Child Support Enforcement (CSE). The recommended and approved solution, referred to as the California Child Support Automation System Child Support Enforcement (CCSAS CSE) Project, is the result of a proposal submitted by IBM and its business partners (Alliance) in response to a performance-based procurement. The contract was signed by the Franchise Tax Board on July 14, 2003.

The Finance Letter (FL) requests a budget augmentation of $17.7 million for additional resources needed to implement year two activities and tasks necessary for continued development of the CCSAS CSE System. The budget augmentation is to realign the Alliance payments needed for 2004/2005; add nine new positions (8.7 PY's); revise the Wide Area Network (WAN) estimates; and Department of General Services (DGS) fees for their contract reviews. Support for this augmentation request can be found in the financial project descriptions and worksheets, and the Resource Justification Report dated January 9, 2004.

Failure to implement a child support automation system that meets federal certification requirements will result in significant impacts for California including continued federal penalties.

In addition to meeting the federal mandates, the successful implementation of child support automation is a vital element of California's Child Support Program (CSP) mission to improve the well-being of the children and families of California.

B. Background/History

AB 150 (Chapter 479, Statutes of 1999) directed the FTB to serve as an agent of the Department of Child Support Services (DCSS) to be responsible for procuring, developing, implementing, and maintaining the operation of the CCSAS statewide. As a result of this legislation, the CCSAS project was initiated. Two provisions of *Welfare and Institutions Code section 10083*, enacted by AB 150, stand out as the key drivers of the CCSAS procurement strategy. These provisions require that the FTB:

> "…shall develop a procurement plan that employs, where appropriate, techniques proven to be successful in the Franchise Tax Board's previous technology efforts and incorporates where possible best practices from other government jurisdictions."
>
> "…consider the events and circumstances that contributed to the failure of the SACSS system …"

In fiscal year (FY) 2003/2004, the project began the first year of system development after receiving both federal and State approvals in June 2003.

C. State Level Considerations

The Governor and the Legislature of California have demonstrated a commitment to building a single statewide child support system that meets federal certification requirements, which provides a high customer service level and that will adapt to the many changes the child support program experiences.

The consequences of not meeting this commitment would have significant negative impact to the General Fund on a statewide basis:

- Federal penalties for non-compliance would continue. The penalty is currently being offset by State General Fund money that reduces the availability of funds for other General Fund programs and services.
- Failure to demonstrate progress in meeting federal requirements to develop a statewide child support system could result in denial of all federal Temporary Assistance for Needy Families (TANF) grant money that would greatly impact the Department of Social Services and California's TANF recipients

These consequences are magnified during a period of economic downturn, budget deficits, and severe fiscal constraints such as California is now experiencing.

D. Justification

This FL is requesting $17.7 mil to continue development and implementation of the CCSAS CSE System as reflected in the financial project descriptions and worksheets. The additional funding is for a realignment of Alliance payments; an additional nine positions; changes to WAN estimates; and for CMAS/MAS DGS Administrative fees.

The FL is required in order to maintain the CCSAS CSE system development and implementation schedule for the second year of development. The following further describes the need and is also included in the financial project descriptions and worksheets.

- Realignment of Alliance payments - $16.2 mil: The CSE project schedule, a major contract deliverable was accepted in January 2004. $12.1 mil is due to realignment for processing Alliance payments. In reviewing the project schedule it was determined that the original assumptions for estimating when payments are to occur needed to be updated to reflect current timeframes. The original payment schedule assumed that contract deliverables would require a longer review and acceptance period. The review times have been shorter than originally anticipated, thus requiring payments to be made earlier than originally planned. The remaining $4.1 mil is needed to correct an oversight in BCP #2. When computing the additional need for FY 2004/2005, the estimated carryover of $4.1 million from 2002/2003 to 2003/2004 was included in FTB's existing base. The carryover is no longer available for 2004/2005 so the additional need for 2004/2005 was understated in BCP #2. This issue was discussed with DOF and it was agreed to reflect the updated budget year need in this FL. The $12.1 mil realignment for the Alliance payment schedule is consistent with the CSE Project

Schedule and is required for 2004/2005. The $12.1 mil does not increase the total contract price.

- Nine Additional Positions - $700,000: One of DOF's conditions for project approval required FTB to submit a report that fully justifies the CSE FTB project resources. On January 9, 2004, FTB submitted the CCSAS CSE Resource Justification Report to DOF and LAO. In that report, FTB justifies the total resource need for the development and implementation services during year two, as well as, the total project. The nine positions requested were identified in the previously approved FSR. The nine positions are critical for the project to be able to continue to work with the Alliance as we continue the development and implementation activities. A summary detail of tasks by function is attached.

- Unanticipated Wide Area Network (WAN) needs - $478,000: The additional WAN connectivity is between the Alliance project site, the CSSAS project site, HHSDC and the San Jose electronic business hosting center (SJ eBHC). The original WAN estimates assumed a connectivity date for these sites in 2005/06. This additional need is the result of requiring connectivity to the IBM SJ eBHC earlier than originally estimated. The early installation is required to provide connectivity for development and performance testing and will be used for statewide connectivity to the production environment. Attached is a matrix that displays the 2003/2004 and 2004/2005 WAN connections as originally planned versus what is needed to be installed to meet the project schedule. This estimate is based on the point in time schedule and the July 2003 Rates Package for connectivity between the Alliance project site, the project site, HHSDC, and the SJ eBHC.

- CMAS/MSA DGS Administrative fees - $281,000: The BCP #2 did not include funding for DGS administrative fees for the review and approval of our contracts and interagency agreements. Based on our contract renewal schedule and the value of the current contracts, funding is required for the fees DGS charges for their services to review and approve our contracts.

E. Analysis of All Feasible Alternatives

Alternative #1 - Approve request for increased resources.

As recommended in the FSR, the CCSAS CSE System was identified as the best option for the State to pursue in order to meet federal mandates, avoid additional federal penalties, and achieve the goals and objectives of California's CSP. The DOF concurred and approved this recommendation on June 12, 2003. Based on this approval, the CCSAS project began development and implementation in the 2003/2004 fiscal year and is requesting the additional resources to continue year two of the project. Approval of the additional resources as requested is critical for this development and implementation effort to continue on track with the approved schedule.

Alternative #2 - Maintain existing baseline – no increase in resources.

Lack of approval of the additional resources may result in:

- A breach of contract with the Alliance and stop the project.

- FTB may not be able to maintain the schedule working with the Alliance and risks the transfer of knowledge for state resources on an ongoing basis.
- De-installation of WAN connectivity between the Alliance project site, project site, HHSDC and the SJ eBHC. This will result in our inability to continue development in a performance environment.

G. Timetable

The following data reflects the timetable for completion of the CCSAS CSE System.

Major Milestones/Key Deliverables	Est. Complete Date
CSE Requirements Analysis	
System/Subsystem Requirements Review – V1	**02/13/04**
System/Subsystem Requirements Review – V2	**03/15/04**
CSE Analysis & Design	
System/Subsystem Design Review – V1	**04/15/04**
Software Requirements Review – V1	**05/14/04**
System/Subsystem Design Review – V2	**08/13/04**
Software Requirements Review – V2	**11/1/04**
Software Design and Code	
Software Design Review – V1	**07/15/04**
Software Design Review – V2	**04/15/05**
CSE Testing	
System Verification Test Readiness Review – V1	**07/15/05**
System Verification Test Readiness Review – V2	**05/10/06**
PRISM Maintenance & Operations	
BEST and CHASER Conversion to CASES Complete	**08/04/05**
PRISM Retirement Complete	**08/29/08**
SDU Procurement & Implementation	
SDU Service Contract Award	**12/15/04**
SDU Readiness Review	**07/31/05**
CSE Version 1 Implementation	
KIDS/STARKIDS Conversion to CASES Complete	**08/04/05**
Operational Readiness Assessment and Review – V1	**11/15/05**
CCSAS Version 1 In Production Use	**02/15/06**
CSE Version 2 Implementation	
Operational Readiness Assessment and Review – V2 Pilot	**09/15/06**
Operational Readiness Assessment and Review – V2 Rollout	**01/16/07**
Statewide CCSAS In Production	**09/15/08**
Completion of Post Implementation Evaluation Report	**09/21/10**

H. Recommendation

Alternative #1 is recommended. This alternative provides the funding needed to continue year two of development of the CSSAS CSE System. The benefits this alternative will provide to the State of California are:

- Compliance with Federal mandate and avoidance of penalties.
- A system responsive to child support program changes.
- Greater net benefits than other alternatives considered.

The CCSAS CSE System is a vital element support California's Child Support program mission to be responsive to the needs of customers, and to contribute to the well-being of the children and families of California. Without the additional funding the State will be unable to meet its obligations to participate in the continued development of the statewide CSSAS CSE System.

Matrix comparing WAN estimates – Original Site and schedule compared to Actual Site and schedule:

Original Sites	Install date	2003/2004 One-time	2003/2004 Ongoing	Actual Sites	Install date	2003/2004 One-time	2003/2004 Ongoing
				Alliance Project Office, Sacto	09/03	8,390.00	8,921.28
Alliance Project Office, Sacto	07/03	4,364.00	227,576.68	Alliance Project Office, Sacto	09/03	7,376.00	57,582.72
HHSDC	07/03	3,794.00	198,399.98	Alliance Project Office, Sacto	01/04	0	85,907.88
				FTB Project Office, Sacto	09/03	5,63.00	71,978.40
				Great Oaks, San Jose	12/03	5,263.00	40,111.28
				Great Oaks, San Jose	12/03	5,263.00	64,665.10
				Great Oaks, San Jose	02/04	0	101,682.05
				Great Oaks, San Jose	02/04	0	163,066.55
				Alliance Project Office, Sacto	12/03	3,786.00	9,96.24
				Alliance Project Office, Sacto	12/03	400.00	4,727.59
Total 2003/04		**8,158.00**	**425,976.66**	**Total 2003/04**		**35,741.00**	**608,039.09**
Original Sites	**Install date**	**2004/2005 One-time**	**2004/2005 Ongoing**	**Actual Sites**	**Install date**	**2004/2005 One-time**	**2004/2005 Ongoing**
				Alliance Project Office, Sacto	09/03		
Alliance Project Office, Sacto	07/03	0	231,684.44	Alliance Project Office, Sacto	09/03		
HHSDC	07/03	0	207,877.60	Alliance Project Office, Sacto	01/04	0	171,815.76
				FTB Project Office, Sacto	09/03	0	86,374.08
				Great Oaks, San Jose	12/03	0	
				Great Oaks, San Jose	12/03	0	
				Great Oaks, San Jose	02/04	0	244,036.92
				Great Oaks, San Jose	02/04	0	391,359.72
				Alliance Project Office, Sacto	12/03	0	16,107.84
				Alliance Project Office, Sacto	12/03	0	8,104.44
Total 2004/05		**0**	**439,562.03**	**Total 2004/05**		**0**	**917,798.76**

STATE OF CALIFORNIA
FINANCE LETTER - COVER SHEET
FOR FISCAL YEAR 2004/05
DF-46 (REV 03/03)

Department of Finance
915 L Street
Sacramento, CA 95814
IMS Mail Code: A-15

FL #	PRIORITY NO	ORG CODE	DEPARTMENT
3		**1730**	**Franchise Tax Board**
PROGRAM	ELEMENT	COMPONENT	
10 Tax Programs	00 All Tax Programs		

TITLE OF PROPOSED CHANGE:

Central Processing Unit (CPU) Augmentation

SUMMARY OF PROPOSED CHANGE:

Provide $1.0 million of funding to augment FTB's CPU to ensure sufficient processing capacity to meet projected workloads through Fiscal Year 2006/07 and avoid negative impacts or delays to revenue producing activities.

REQUIRES LEGISLATION	CODE SECTION(S) TO BE AMENDED/ADDED	BUDGET IMPACT-PROVIDE LIST AND MARK IF APPLICABLE
☐ YES ☒ NO		☒ ONE-TIME COST ☐ FULL-YEAR COSTS ☐ FACILITIES/CAPITAL COSTS ☐ FUTURE SAVINGS ☐ REVENUE

PREPARED BY:	DATE	REVIEWED BY:	DATE
PROGRAM APPROVAL:			
DEPARTMENT DIRECTOR:	DATE	AGENCY SECRETARY:	DATE

IF PROPOSAL AFFECTS ANOTHER DEPARTMENT, DOES OTHER DEPARTMENT CONCUR WITH PROPOSAL? N/A

☐ YES ☐ NO

ATTACH COMMENTS OF AFFECTED DEPARTMENT SIGNED AND DATED BY THE DEPARTMENT DIRECTOR OR DESIGNEE.

FOR INFORMATION TECHNOLOGY REQUESTS, SPECIFY THE DATE SPECIAL PROJECT REPORT (SPR) OR FEASIBILITY STUDY REPORT (FSR) WAS APPROVED BY THE DEPARTMENT OF FINANCE PENDING.

DATE PROJECT # FSR ☒ FTB FSR 03-03 OR SPR ☐

DOF ANALYST USE
(ADDITIONAL REVIEW)

CAPITAL OUTLAY ☐ TIRU ☐ FSCU ☐ OSAE ☐ CALSTARS ☐

STATE OF CALIFORNIA
FINANCE LETTER - FISCAL DETAIL
FOR FISCAL YEAR 2004/05
DF-46 (REV 03/03)

Department of Finance
915 L Street
Sacramento, CA 95814
IMS Mail Code: A-15

FL # 3	**DATE 2/6/2004**	**Title of Proposed Change:** **CPU Augmentation**
PROGRAM **Tax Programs**	**ELEMENT** **All Tax Programs**	**COMPONENT**

	Personnel Years			
	CY	BY	Current Year	Budget Year
Total Salaries & Wages a/	.0	.0	$ 0	$ 0
Salary Savings	.0	.0	$ 0	$ 0
Net Total Salaries and Wages	.0	.0	$ 0	$ 0
Staff Benefits b/			$ 0	$ 0
Total Personal Services			$ 0	$ 0

Operating Expenses and Equipment	Current Year	Budget Year
General Expenses	$ 0	$ 0
Printing	0	0
Communications	0	0
Postage	0	0
Travel-In-State	0	0
Travel Out-of-State	0	0
Training	0	0
Facilities Operations	0	0
Utilities	0	0
Cons & Prof Svs - Interdept'l	0	0
Cons & Prof Svs - External	0	0
Consolidated Data Center	0	0
California Health and Human Services Agency Data Center	( )	( )
Stephen P. Teale Data Center	( )	( )
Data Processing /1	0	701,000
Equipment /2	0	312,000
Other Items of Exp (Specify Below)	0	0
Total Operating Expense & Equipment	$ 0	$ 1,013,000

a/ Itemized detail on Page II-3 by classification as in Salaries and Wages Supplement.
b/ Detail provided on following pages.
/1 Includes one-time software purchase of $936,000 and continuing software upgrade maintenance costs of $230,000; reduced by $465,000 baseline funding.
/2 Total hardware includes $708,000 for CPU processor and $228,000 for 4 GB of memory and board, financed over 3 years (interest included).

	Current Year	Budget Year

TOTAL OPERATING EXPENSES AND EQUIPMENT				$ 0	$ 1,013,000
SPECIAL ITEMS OF EXPENSE d/					
				$ 0	$ 0
PROGRAM ADMINISTRATION				$ 0	$ 0
Distributed Admin				$ 0	$ 0
TOTAL STATE OPERATIONS EXPENDITURES				$ 0	$ 1,013,000
Source of Funds	**Appropriation No.**				
	Org	Ref	Fund		
General Fund	1730	001	0001	$ 0	$ 1,013,000
				0	0
				0	0
				0	0
				0	0
				0	0
				0	0
Reimbursements	1730	501	0995	0	0
Totals				$ 0	$ 1,013,000
LOCAL ASSISTANCE				$(0)	$(0)
Source of Funds	**Appropriation No.**				
	Org	Ref	Fund		
General Fund	1730	001	0001	$ 0	$ 0
				0	0
				0	0
				0	0
				0	0
Reimbursements				0	0
Totals				$ 0	$ 0

d/ Special Items of expense must be titled. Please refer to the Uniform Codes Manual for a list of the standardized Special Items of expense objects which may be used.

Department **Franchise Tax Board** FL 3
CPU Augmentation

FISCAL YEAR 2004/05
SUPPLEMENTAL INFORMATION
($ in Thousands)

Identify all proposed items which fit into the categories listed below.

		Current Year	Budget Year	Budget Year + One
Proposed Equipment				
CPU Processor and 4 GB memory /1	1730 - 001 - 0001 General Fund - Tax	$ 0	312	$ 0
Total		$ 0	312	$ 0
One-Time Costs				
Software purchase and maint. /2	1730 - 001 - 0001 General Fund - Tax	$ 0	140	$ 0
Total		$ 0	$ 140	$ 0

FOOTNOTES
/1 CPU processor and 4 GB Memory to be financed over 3 years beginning in FY 2004/05
$312,000 is the yearly amount of installment payment.
/2 One time software purchase is reduced to cover increased maintenance costs in the out years.

FRANCHISE TAX BOARD
Fiscal Year 2004/05

Finance Letter **No. 3**

CPU Augmentation 2004/05 **Date: February 6, 2004**

A. NATURE OF REQUEST

The Franchise Tax Board (FTB) requests an augmentation of $1,013,000 to increase the mission critical processing capacity of the Central Processing Unit (CPU) by 18 percent and to increase memory capacity by 28 percent to meet projected capacity requirements and maintain acceptable system performance levels for FY 2004/05 through FY 2006/07. By adding a third processor and 4 Gigabytes (GB) of memory, the CPU will have the resources necessary to effectively handle growth in existing workloads through FY 2006/07. There is no PY impact.

B. BACKGROUND/HISTORY

The FTB collects tax revenues and operates other non-tax programs entrusted to it at the least cost; serves the public by continually improving the quality of its products and services, and performs in a manner warranting the highest degree of public confidence in its integrity, efficiency and fairness. The department administers the Personal Income Tax (PIT) Law, the Bank and Corporation Tax (B&C) Law, and the Homeowner's and Renter's Assistance (HRA) Program. In addition, it is responsible for audits pursuant to the Political Reform Act, collection of delinquent child support payments, vehicle registration fees, other debts as authorized or required by the Legislature, and settlements of civil tax matter disputes which are the subject of protest, appeals, or refund claims.

The programs administered by the FTB contribute over 61% of the General Fund Revenue. The FTB's business processes are supported by a full service data center. The data center processes approximately 49 million online transactions and over 120,000 batch processes per month during peak season. The data center also generates over 3 million print pages per month for notices, bills and letters during peak.

Data center customers and users include all of FTB's program areas, including PIT, B&C, HRA, and various non-tax debt collections programs. FTB's data center also provides data storage and processing service to a number of external customers such as Board of Equalization, Employment Development Department, Department of Food and Agriculture, etc.

In November 2001, FTB purchased and installed an IBM e-Server z900 Series Central Processing Unit (CPU)[1] with two processors and 14 GB of memory to support these services (Data Center Infrastructure Improvement FTB FSR 99-36). The IBM e-Server replaced a Hitachi Data Systems (HDS) Skyline 413 Central Processing Unit (CPU). The acquisition allowed the creation of an infrastructure with flexibility and speed to deploy e-business[2] solutions utilizing addressable memory through 64-bit addressing.

During the 2003 peak season, the department's capacity planning metric[3] reached 98 to 99 percent of total CPU capacity (currently, maximum capacity on the CPU is 476 MIPS). Industry guidelines recommend maintaining normal operating capacity at less than 90 percent of available CPU capacity or 428 MIPS (90% of 476). Based on projected workload growth for FY2003/04, we will be at 101% of maximum capacity or 482 MIPS, requiring re-prioritization of workloads. Based on projected workload growth of 22 MIPS (from 471 to 493 MIPS total, refer to Table 1 below) for FY2004/05, the CPU will lack the required capacity to provide efficient and effective administration of our business processing workloads (refer to Section E for consequences of not increasing the CPU capacity in FY 2004/05). In addition, a 10 percent buffer of CPU capacity makes the total MIPS requirement equal to 542 MIPS for FY 2004/05.

Attachment A displays MIPS usage in programmatic detail for FY 2002/03 (baseline), as well as the projected MIPS for FY 2003/04 through FY 2006/07. In general the MIPS projections reflect increases for PIT and B&C workloads.

The following fiscal year display is the summary of the department's MIPS usage shown on Attachment A. Attachment B is a chart showing the MIPS historical growth and the projected MIPS with a 10 percent buffer. Table 1 below summarizes data on Attachments A & B.

Table 1

	FY 2002/03 ***Baseline***	**FY 2003/04** ***Projected***	**FY 2004/05** ***Projected***	**FY 2005/06** ***Projected***	**FY 2006/07** ***Projected***
MIPS Usage	471	482[4]	493	506	518
MIPS Usage plus 10% buffer	518[4]	530[4]	542	557	570

C. STATE LEVEL CONSIDERATIONS

[1] IBM z900 e-Server/2064-1C2 (mainframe with two processors) running under a z/OS operating system.
[2] e-Business including web-based, interactive (browser based), and program-to-program interoperation.
[3] A capacity planning metric reflects actual historical capacity usage during hourly intervals with the highest monthly value averaged over a year to project future capacity usage.
[4] Current machine capacity is only 476 MIPS; therefore the value shown is the computed requirement.

The FTB is legislatively mandated to administer California's state tax law. The additional CPU capacity and memory will result in a positive impact, ensuring FTB operates without interruptions in service to other data centers utilizing the FTB data center, as well as to California taxpayers, through FY 2006/07.

D. FACILITY/CAPITAL OUTLAY CONSIDERATIONS

There is no impact to facilities or any capital outlay considerations as a result of the upgrade.

E. JUSTIFICATION

Based on projected workloads in FY 2004/05, the department will experience a serious performance degradation of an estimated 5 percent due to a combination of CPU and memory limitations, resulting in a backlog of returns, audits, collection accounts and correspondence. With the current system, insufficient capacity will limit FTB's ability to meet anticipated workload growth. This will result in severe economic impacts including: 1) the risk of increased interest costs on refund returns, 2) delayed receipt of cash payments resulting in lost interest on revenue, and 3) reduced efficiencies in the Audit and Collections programs equating to delays in revenue production.

The delay in processing tax returns and audit and collection activities—resulting from capacity issues—is conservatively anticipated to be at least seven working days beginning in Fiscal Year 2004/05. This delay will require the State to pay additional interest on refunds due to taxpayers and will reduce the interest owed to the State on balance due notices and other correspondence. This equates to a revenue loss estimated at $932,000 per year or $2.8 million over a three-year period. The 5% interest rate currently paid on personal income tax refunds and assessed on balances due was used to calculate the revenue loss. The current interest rate on Corporation refund returns is 1%.

The $932,000 annual revenue loss is a combination of additional interest paid to taxpayers, interest owed the State on balance due notices and a delay in audit, collections and non-tax collection programs. The total revenue loss can be categorized as follows:

- Estimated additional interest paid to taxpayers
  Increased interest cost on refund returns
    - $711,000 annually
        - $644,000 for personal income tax
        - $67,000 for corporate tax

- Estimated reduction in interest owed the State on balance due notices Returns not processed timely
  - $117,000 annually
    - $83,000 for personal income tax
    - $34,000 for corporate tax

- Audit, Collections and Non-Tax Collection Programs interest loss
  - A delay in issuing a balance due notice, NPA or correspondence to the taxpayer
    - $104,000 annually

This proposal is consistent with Goal #4 "Deliver Efficient and High-Quality Business Results" of the department's strategic plan by providing the necessary e-Server / Mainframe and Open Systems support functions, consistent with the increasing demand for those functions. This proposal also contributes to the following department's strategic plan goals: Goal #2 "Promote Fair and Effective Tax Administration", Goal #3 "Build a Strong Organization", and Goal #5 "Protect Taxpayer Privacy and Ensure Security of Taxpayer Information".

F. ANALYSIS OF ALL FEASIBLE ALTERNATIVES

ALTERNATIVE #1 – Augment FTB's budget by $1,013,000 to upgrade our current IBM zSeries Server by adding a third processor and additional 4 GB of memory.

This solution will provide the capacity to efficiently and effectively support workload growth of programs and applications. Adding processor capacity will prevent performance degradation that would impact revenue production. A 10% capacity buffer is necessary to allow for unforeseen workload peaks and to prevent response degradation that occurs when systems approach full utilization. Adding 4 GB of memory is required for effectively handling growth of our existing mission critical applications workloads (see Exhibit A), as well as, the increased workloads enabled by the addition of a third processor.

With the third processor and additional memory, the department will have a processing speed of 687[5] MIPS and 18 GB of memory available to support workload growth.

[5] CPU MIPS are purchased in increments. The next available increment for the IBM e-Server is an additional 211 MIPS for a total of 687.

ALTERNATIVE #2– Augment FTB's budget by $933,000 to add a third processor without additional memory.

This alternative will add resources (CPU but not memory) to support projected growth in existing workloads, while costing less than our proposed solution. However, without the 4 GB of memory the department will not be able to effectively manage mission critical applications and workload growth, plus there will be no ability to take advantage of the third processor by increasing the system's level of multi-processing. This will severely impact the support functions provided by the department's Computing Resources Bureau, resulting in the inability to process workloads during identified critical processing timeframes of FY2004/05's peak season. While workloads can be prioritized in FY 2003/04 to manage workload growth and its impact on capacity, the growth expected in FY 2004/05 is greater than our ability to manage with the current CPU and memory. As a result, there will be a cumulative backlog of returns, audits, collection accounts and correspondence. Economic impacts will include increased interest costs on refund returns and delayed receipt of cash payments of additional assessments from return processing.

Reduced efficiencies in the Audit and Collection Programs resulting in the inability to process audits and collection cases will equate to revenue delays. In addition, this drastically reduces our ability to take on additional workloads without degradation to our current mission critical processes.

ALTERNATIVE # 3 – Maintain the current system.

This alternative will not require additional funding. To maintain the current system will severely impact the support functions provided by the department's Computing Resources Bureau, resulting in the inability to process workloads during identified critical processing timeframes of FY2004/05's peak season. While workloads can be prioritized in FY 2003/04 to manage workload growth and its impact on capacity, the growth expected in FY 2004/05 is greater than our ability to manage with the current CPU. As a result, there will be a cumulative backlog of returns, audits, collection accounts and correspondence. Economic impacts will include increased interest costs on refund returns and delayed receipt of cash payments of additional assessments from return processing.

Reduced efficiencies in the Audit and Collection Programs resulting in the inability to process audits and collection cases will equate to revenue delays. In addition, this drastically reduces our ability to take on additional workloads without degradation to our current mission critical processes.

OTHER OPTIONS CONSIDERED

One option considered was the possibility of introducing a new hardware vendor but retaining the same mainframe operating system. With this approach, all peripheral devices currently in place could be utilized and modifications to business applications or to third party vendor software would not be required. However, neither of IBM's competitors currently produces mainframe hardware. Nearly two years ago, both Amdahl Corporation and Hitachi Data Systems announced their phased departure from the System/390 marketplace.

A second option considered bidding and potentially migrating to another operating system and platform. This approach would require the replacement of our current mainframe hardware and all supporting system software. A switch to another operating system would necessitate the purchase of all new peripheral devices (e.g., Direct Access Storage Devices, tape library cartridges, tape drives and large enterprise printers) and would require reprogramming of over 6,000 application programs. The cost of replacing the mainframe hardware and operating system would exceed that of the proposed solution and would take five years to complete. After review, neither approach was considered feasible, therefore not pursued.

G. TIMETABLE

Task	Start	Finish	Deliverable	Milestone
Obtain Internal FSR approval	1/12/04	1/13/04	FSR	FSR approved internally
Obtain External FSR approval	1/14/04	3/15/04	FSR	FSR approved externally
Start Project	6/1/04	6/1/04		Project started
Develop NCBCJ	6/1/04	9/1/04	NCBCJ	NCBCJ approved
Develop Purchasing Document	9/1/04	10/1/04	Purchase order	Purchase order released
Receive, Install and test CPU & Memory	11/27/04	11/28/04	Installation sign-off document	Installation completed
Implementation	12/1/04	12/1/04	Implementation sign-off document	Implementation completed
Prepare Post Implementation Evaluation Report (PIER)	10/1/05	10/30/05	PIER	PIER completed

H. RECOMMENDATION

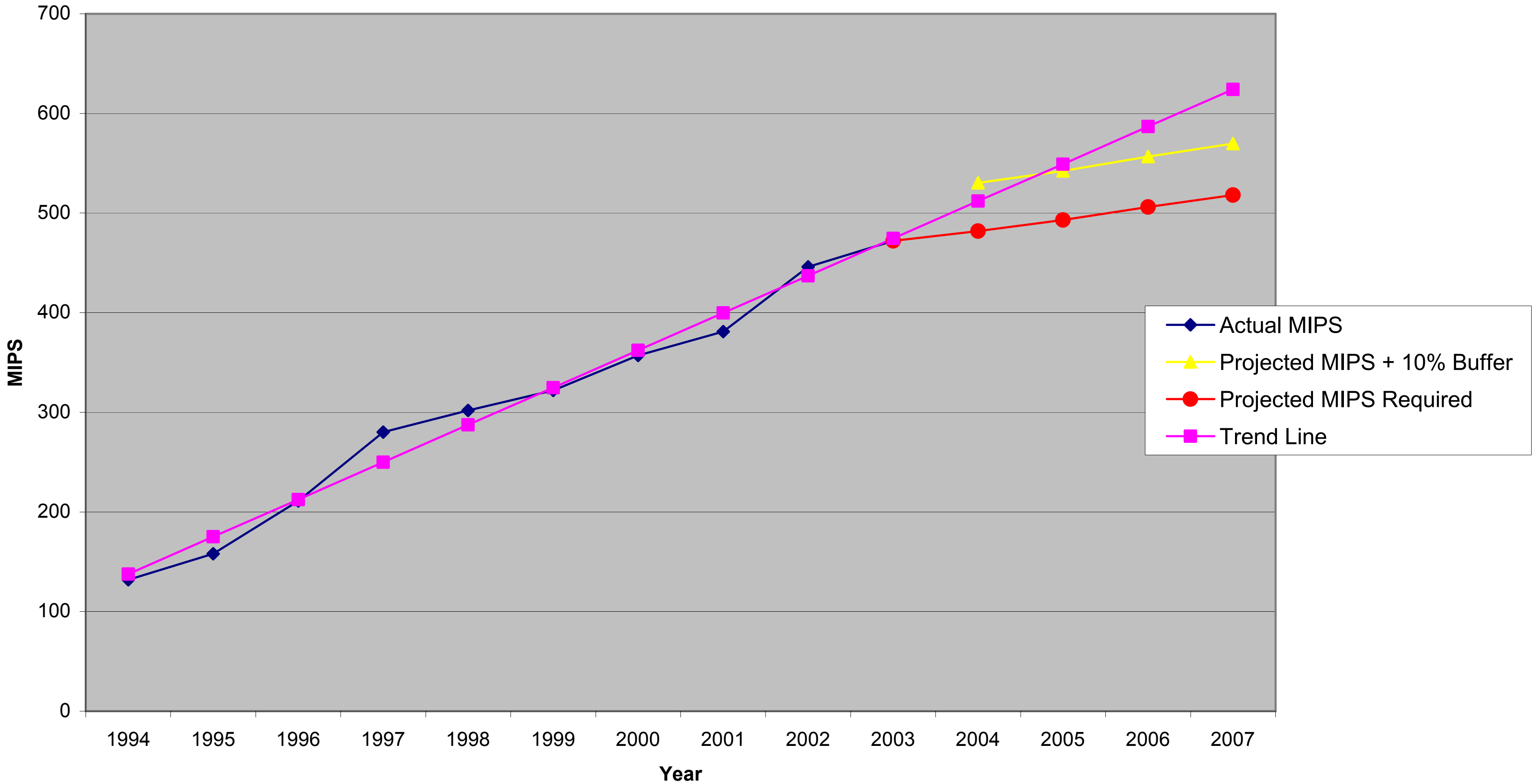
The FTB recommends approval of Alternative #1. This alternative best meets the objectives and functional requirements detailed in the Feasibility Study Report previously submitted. This alternative will provide the capacity to efficiently and effectively support workload growth of programs and applications. Additionally, the increased capacity and memory will prevent performance degradation that would impact revenue production, positioning the FTB to effectively handle growth of our existing mission critical applications workloads, as well as, the increased workloads enabled by the addition of a third processor. At its meeting on September 17, 2003, the Franchise Tax Board itself approved the funding request for the CPU Augmentation. This funding request was submitted to the Department of Finance in the fall of 2003 as a BCP. At that time, the Department of Finance requested that the FTB resubmit the request in the spring as a Finance Letter.

Attachment A CPU MIPS Usage by Program Area

FY 2002/03 Baseline with CPU MIPS Changes thru FY 2006/07					
Workloads	FY 02/03 Actual MIPS	FY 03/04 Projected MIPS	FY 04/05 Projected MIPS	FY 05/06 Projected MIPS	FY 06/07 Projected MIPS
PRODUCTION:					
Personal Income Tax					
Return/Estimate Processing	166	170	173	177	181
Taxpayer Assistance					
General Info. Calls/Revenue Calls	62	64	65	66	68
Correspondence	4	4	4	4	4
Audit	16	17	19	20	21
Collections	82	84	85	87	89
Filing Enforcement	5	5	5	5	5
Corporations					
Return/Estimate Processing	83	85	88	90	92
Taxpayer Assistance					
General Info. Calls/Revenue Calls	6	6	6	7	7
Public Service	3	3	3	4	4
Audit	8	8	8	8	8
Collections	23	24	24	25	26
Filing Enforcement	1	1	1	1	1
Homeowners & Renters Asst.	2	2	3	3	3
DMV Collections	2	2	2	2	2
Child Support Collections	7	6	6	6	6
Court Ordered Debt	1	1	1	1	1
TOTAL	**471**	**482**[6]	**493**	**506**	**518**
10 % Capacity Buffer	5[7]	48[6]	49	51	52
TOTAL REQUIRED CAPACITY	**476**	**530**[6]	**542**	**557**	**570**

[6] Represents projected demand only, as the zSeries system will still have only 476 MIPS total capacity.
[7] Maximum additional MIPS available based on capacity of the zSeries system as configured with 2 processors.

Attachment B CPU MIPS Usage – Historical and Projected



STATE OF CALIFORNIA
FINANCE LETTER - COVER SHEET
FOR FISCAL YEAR 2004/05
DF-46 (REV 03/03)

Department of Finance
915 L Street
Sacramento, CA 95814
IMS Mail Code: A-15

FL #	PRIORITY NO	ORG CODE	DEPARTMENT
4		1730	**Franchise Tax Board**
PROGRAM	ELEMENT	COMPONENT	
10 Tax Programs	10 Personal Income Tax		

TITLE OF PROPOSED CHANGE:

Abusive Tax Shelters

SUMMARY OF PROPOSED CHANGE:

Provide funding for the department to contract with economists and financial products experts to assist with the audits of abusive tax shelters in accordance with the provisions of Chapter 656, Statues of 2003 (SB 614, Cedillo).

REQUIRES LEGISLATION	CODE SECTION(S) TO BE AMENDED/ADDED	BUDGET IMPACT-PROVIDE LIST AND MARK IF APPLICABLE
☐ YES ☒ NO		☐ ONE-TIME COST ☐ FULL-YEAR COSTS ☐ FACILITIES/CAPITAL COSTS ☐ FUTURE SAVINGS ☒ REVENUE

PREPARED BY:	DATE	REVIEWED BY:	DATE
PROGRAM APPROVAL:			
DEPARTMENT DIRECTOR:	DATE	AGENCY SECRETARY:	DATE

IF PROPOSAL AFFECTS ANOTHER DEPARTMENT, DOES OTHER DEPARTMENT CONCUR WITH PROPOSAL? N/A

☐ YES ☐ NO

ATTACH COMMENTS OF AFFECTED DEPARTMENT SIGNED AND DATED BY THE DEPARTMENT DIRECTOR OR DESIGNEE.

FOR INFORMATION TECHNOLOGY REQUESTS, SPECIFY THE DATE SPECIAL PROJECT REPORT (SPR) OR FEASIBILITY STUDY REPORT (FSR) WAS APPROVED BY THE DEPARTMENT OF FINANCE.

DATE PROJECT # FSR ☐ OR SPR ☐

DOF ANALYST USE
(ADDITIONAL REVIEW)

CAPITAL OUTLAY ☐ TIRU ☐ FSCU ☐ OSAE ☐ CALSTARS ☐

STATE OF CALIFORNIA
FINANCE LETTER - FISCAL DETAIL
FOR FISCAL YEAR 2004/05
DF-46 (REV 03/03)

Department of Finance
915 L Street
Sacramento, CA 95814
IMS Mail Code: A-15

FL # 4	**DATE** 2/6/2004	**Title of Proposed Change:** Abusive Tax Shelters
PROGRAM Tax Programs	**ELEMENT** Personal Income Tax	**COMPONENT**

	Personnel Years CY	Personnel Years BY	Current Year	Budget Year
Total Positions / Salaries & Wages	.0	.0	$ 0	$ 0
Part-year adjustment	0.0	0.0	$ 0	$ 0
Total Salaries & Wages a/	.0	.0		
Salary Savings	0.0	0.0	$ 0	$ 0
Net Total Salaries and Wages	.0	.0	$ 0	$ 0
Staff Benefits b/			$ 0	$ 0
Total Personal Services			$ 0	$ 0

Operating Expenses and Equipment	Current Year	Budget Year
General Expenses	$ 0	$ 0
Printing	0	0
Communications	0	0
Postage	0	0
Travel-In-State	0	0
Travel Out-of-State	0	0
Training	0	0
Facilities Operations	0	0
Utilities	0	0
Cons & Prof Svs - Interdept'l	0	0
Cons & Prof Svs - External /1	0	400,000
Consolidated Data Center	0	0
California Health and Human Services Agency Data Center	( )	( )
Stephen P. Teale Data Center	( )	( )
Data Processing	0	0
Equipment	0	0
Other Items of Exp (Specify Below)	0	0
Total Operating Expense & Equipment	$ 0	$ 400,000

a/ Itemized detail on Page II-3 by classification as in Salaries and Wages Supplement.
b/ Detail provided on following pages.
1/ Estimated amount required to hire economists and financial products experts at $400 per hour for 1000 hours.

	Current Year	Budget Year
TOTAL OPERATING EXPENSES AND EQUIPMENT	$ 0	$ 400,000
SPECIAL ITEMS OF EXPENSE d/	$ 0	$ 0

PROGRAM ADMINISTRATION				$ 0	$ 0
Distributed Admin				$ 0	$ 0
TOTAL STATE OPERATIONS EXPENDITURES				$ 0	$ 400,000
Source of Funds	**Appropriation No.**				
	Org -	Ref -	Fund		
General Fund	1730	001	0001	$ 0	$ 400,000
				0	0
				0	0
				0	0
				0	0
				0	0
				0	0
Reimbursements	1730	501	0995	0	0
Totals				$ 0	$ 400,000
LOCAL ASSISTANCE				$(0)	$(0)
Source of Funds	**Appropriation No.**				
	Org -	Ref -	Fund		
General Fund	1730	001	0001	$ 0	$ 0
				0	0
				0	0
				0	0
				0	0
Reimbursements				0	0
Totals				$ 0	$ 0

d/ Special Items of expense must be titled. Please refer to the Uniform Codes Manual for a list of the standardized Special Items of expense objects which may be used.

DETAIL OF STAFF BENEFITS
AND PERSONAL SERVICES

	Positions			Amount	
Positions	**CY**	**BY**	**Salary Range**	**CY**	**BY**

Schedule of Staff Benefits Costs
FOR FISCAL YEAR 2004/05

Staff Benefits	2003/04	2004/05
OASDI /1	$ 0	$ 0
Dental /2	0	0
Health /3	0	0
Retirement /4	0	0
Vision /5	0	0
Medicare /6	0	0
Worker's Comp /7	0	0
Industrial Disability /8	0	0
Non Industrial Disability /9	0	0
Unemployment Insurance /10	0	0
Total Staff Benefits	$ 0	$ 0

1/ For permanent and overtime, 6.2% of net salary.
2/ For permanent, $500 per net personnel year.

3/ For permanent, $5,800 per net personnel year.
4/ For permanent, 7.413% of net salary.
5/ For permanent, $100 per net personnel year.
6/ 1.45% of net salary for permanent.
7/ 1.12% of net salary for permanent.
8/ 0.1% of net salary for permanent.
9/ 0.11% of net salary for permanent.
10/ 12.89% of net salary for temporary help.

Department **Franchise Tax Board** FL 4
Abusive Tax Shelters

FISCAL YEAR 2004/05
SUPPLEMENTAL INFORMATION
($ in Thousands)

Identify all proposed items which fit into the categories listed below.

	Current Year	Budget Year	Budget Year + One
Proposed Equipment			
	$ 0	$ 0	$ 0
Total	$ 0	$ 0	$ 0
Proposed Contracts			
Abusive Tax Shelters Experts	$ 0	$ 400	$ 400
Total	$ 0	$ 400	$ 400
One-Time Costs			
	$ 0	$ 0	$ 0
	0	0	
Total	$ 0	$ 0	$ 0
Future Savings			
	$ 0	$ 0	$ 0
Total	$ 0	$ 0	$ 0
Full-Year Cost Adjustments			
	$ 0	$ 0	$ 0
Total	$ 0	$ 0	$ 0
Facilities/Capital Costs			
	$ 0	$ 0	$ 0
Total	$ 0	$ 0	$ 0

FRANCHISE TAX BOARD
Fiscal Year 2004/2005

Finance Letter **FL No. 4**

Abusive Tax Shelters **Date: February 6, 2004**

A. Nature of Request

This proposal is requesting $400,000 in FY 2004/05 and FY 2005/06 for the cost of contracting with economists and financial products experts to assist with the audits of abusive tax shelters. These resources are required to successfully audit abusive tax shelters and enforce the provisions of Chapter 656, Statutes of 2003 (SB 614, Cedillo), which increases the penalties imposed with respect to tax avoidance and abusive tax shelters and requires the Franchise Tax Board to develop and administer a voluntary compliance initiative to be conducted during the period from January 1, 2004 to April 15, 2004, inclusive.

B. Background/History

Abusive tax shelters are considered one of the most significant areas of tax abuse.

Effective January 1, 2004, Chapter 656, Statutes of 2003 (SB 614, Cedillo) adds new penalties on abusive tax shelters, increases penalties imposed on all parties involved with tax shelters and conforms to federal disclosure requirements for reportable transactions. Additional provisions include:

- Extending the statute of limitations to eight years for taxpayers to receive a deficiency notice regarding tax shelters (for tax years 1999 and subsequent).
- A 40% penalty on understatements of tax liability from transactions lacking economic substance.
- A 30% penalty on understatements of tax liability from undisclosed reportable transactions.
- A penalty equal to 100% of the accrued interest on deficiencies related to tax shelters.
- A 50% penalty on the gross income that promoters earn from promoting tax shelters.

In addition, the legislation provides for a one-time voluntary compliance initiative (VCI). This initiative permits a taxpayer to file an amended return and pay the tax and interest associated with the abusive tax shelter, thereby avoiding all current penalties and additional penalties imposed by this legislation.

FTB is currently identifying and auditing a number of abusive tax shelter cases. This legislation is a vehicle to identify additional non-compliance workloads in this area. It is anticipated that through the VCI, many taxpayers will come forward and file amended returns along with a claim for refund to protect their right of appeal. These claims may require an

audit of the facts presented. FTB has estimated that the VCI and tax shelter audits will yield close to $600 million over the next four years in assessments and self-compliance benefits with existing auditor resources and the request contract services.

In order to audit the claims and enforce the penalties included in this legislation, FTB staff will need to develop facts, scrutinize promotional materials, and refute experts that the taxpayer has heretofore relied upon. These audits are often multifaceted and complex. Audit findings in each case will be based not only upon technical issues (e.g. tax laws, court cases, etc.), but also on arguments of economic substance, and questions on whether the taxpayer entered into the transactions with a profit motive or business purpose, or only for tax savings. This will call into account the taxpayer's intent as well as financial history. Additionally, administration of the new 40% penalty for transactions lacking economic substance requires that the FTB prove that the transaction lacks a California business purpose.

FTB is working in partnership with the IRS and although FTB will be working different cases, there needs to be consistency with the reasons for disallowing tax shelter losses. FTB staff will need to understand the transactions and the reasons to disallow tax shelters on the same level as the IRS. Because of the complex nature of abusive tax shelter audits, the IRS has found it necessary to employ financial products experts, economists, and engineers on staff to augment the knowledge and skills of their audit staff. They supplement these resources with additional expertise on a consultant basis.

The area of abusive tax shelters is relatively new to auditors at FTB, and our experience falls far short of the IRS in these types of audits. Therefore, the FTB audit program needs to acquire additional expertise comparable to that utilized by the IRS in the field of tax shelters. The most efficient means for FTB to acquire this expertise within the timeframes of these audits is to contract for economists and financial products experts in the field of tax shelters to consult on an hourly basis and assist us with abusive tax shelter audits over a two-year period. FTB expects to utilize these resources in a number of areas:

- Provide analysis of shelters - FTB auditors will need assistance in identifying aspects of transactions that can provide the basis for audit findings.
- Provide expertise in overseas financial markets - Offshore transactions and shelters require expertise in European financial markets, which our auditors have not had experience in before.
- Lend credibility to our positions – FTB auditors will find themselves in an adversarial role against sophisticated and aggressive tax shelter organizers, many with vast resources at their disposal.
- Assist sustaining our positions – In order for us to prevail in the successful elimination of abusive tax shelters, we need to incorporate the arguments of these experts in our positions. Use of experts at a later stage in the process may not achieve the same success that may be gained by using experts at the beginning of our process.

We anticipate using approximately 1,000 hours per year at a cost of $400 per hour for a total of $400,000 per year in both FY 2004/05 and FY 2005/06.

C. <u>State Level Consideration</u>

FTB is mindful of the existing state budget deficit and considers this expenditure of funds as a means to maximize our ability to produce additional revenue to the General Fund.

D. Justification

This proposal allows us to meet duel goals of promoting fair and effective tax administration and delivering efficient high quality business results. The cost of the outside consultants should be more than recouped in General Fund revenues stemming from higher quality and more sustainable tax shelter audit cases.

E. Analysis Of All Feasible Alternatives

Alternative #1 – Provide $400,000 in consultant and professional services funding.

This proposal will allow FTB to contract with knowledgeable and expert resources in the field of abusive tax shelters, thereby providing the basis for strong, sustainable tax shelter audit cases. In addition to strengthening our stance on these cases, these resources will lend credibility to our audit positions and contribute to long-term development of FTB staff.

Alternative #2 – Do not provide the resources.

All tax shelter audits will be completed to the very best of our ability utilizing existing in-house resources. However, without the same resources and experience that the IRS has available to them, we anticipate a somewhat lower success rate with these audits.

F. Timetable

Audits of abusive tax shelters typically take 18 to 24 months. We have identified a number of cases and expect to identify additional cases as result of the VCI. It is anticipated that the bulk of the work on those tax shelter audits identified will be completed during FY 2004/05 and FY 2005/06.

G. Recommendation

Alternative #1 is recommended. This alternative provides the additional resources to acquire advanced skill sets in such areas as financial products, economics, and engineering that will strengthen and support our audits of tax shelters. At its meeting on September 17, 2003, the Franchise Tax Board itself approved the request for additional resources to combat abusive tax shelters. This funding request was submitted to the Department of Finance in the fall of 2003 as a BCP. At that time, the Department of Finance requested that the FTB resubmit the request in the spring a Finance Letter.